Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
GTE Telephone Operating Companies	)	CC Docket No. 92-141
	)	
Investigation of Below-band	)	Transmittal Nos. 711 and 750
Transport Rates	)	

MEMORANDUM OPINION AND ORDER

Adopted: December 23, 1994; Released: December 29, 1994

By the Commission:

I. BACKGROUND

1. In its 1992 annual access tariff filing, the GTE Telephone Operating Companies (GTE) filed substantially reduced below-band rates for transport service in several GTE study areas.[1] Below-band filings must be accompanied by a showing that the rates will cover average variable costs (AVC), and are otherwise just, reasonable, and nondiscriminatory.[2]

2. Some of GTE's below-band transport rates were lowered to a level at or near the average variable cost reported in its study. GTE's average variable cost showing, however, consisted only of summary results of incremental cost studies. Consequently, in the 1992 Annual Access Order,[3] the Common Carrier Bureau concluded that GTE failed

[1]GTE filed below-band rates for GTE California, GTE Florida, GTE Southwest and GTE Washington/Oregon/California-West-Coast. GTE Direct Case at 2.

[2]See Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786, 6814, (para. 226) and 6824 (paras. 309-311) (1990) (LEC Price Cap Order); Policy and Rules Concerning Rates for Dominant Carriers, Order on Reconsideration, 6 FCC Rcd 2637, 2699 (para. 137) (LEC Price Cap Reconsideration Order).

[3]1992 Annual Access Tariff Filings, CC Docket No. 92-141, 7 FCC Rcd 4734 (1992) (1992 Annual Access Order).

to adequately support its below-band transport rates, and suspended those rates for five months pending an investigation to ensure that they were not predatory.[4]

3. In order to evaluate the reasonableness of GTE's filing, the Common Carrier Bureau directed GTE to file a direct case on July 27, 1992. In its direct case, GTE was instructed to: 1) provide the full incremental cost studies supporting its AVC showing results, e.g., the type and cost of equipment used to provide transport and the amount of usage of the equipment; and 2) demonstrate that its rates are just, reasonable and nondiscriminatory. In addition, the Bureau designated two issues for resolution: (1) whether GTE's below band rates are above GTE's average variable costs; and (2) whether GTE's rates are otherwise just, reasonable and nondiscriminatory. In its direct case, GTE provided AVC studies for California, Florida, Southwest and GTE of Washington/Oregon/California-West Coast. GTE's direct case included four components: (i) summary workpapers combining the various cost sub-elements into the total investment required for each rate element; (ii) detail workpapers showing the material, engineering and installation costs of the equipment used to build each specified cost sub-element; (iii) workpapers representing the original summarized AVC results as filed in GTE's 1992 annual access filing; and (iv) return and income tax calculation workpapers. GTE maintains that the rate reductions at issue cover their average variable costs and are otherwise just, reasonable and nondiscriminatory. See GTE Direct Case at 11-15.

4. The Association for Local Telecommunications Services (ALTS) filed an opposition to GTE's direct case on August 17, 1992. ALTS first argues that in resolving the designated issues, the Commission must ensure that all variable costs associated with providing GTE's switched transport services are recovered through the appropriate rate elements. ALTS Opposition at 3. In order to capture a reasonable representation of a LEC's variable costs, ALTS contends, the Commission must take into account the accelerated levels of new investment in fiber optic facilities by considering cost data over a "reasonable" period of time. Id. at 4. ALTS therefore requests that the Commission clarify that the AVC test requires an averaging of LEC investment data over the most recent five-year period to account for distortions caused by "lumpy investment." Id. at i, 5.

5. In its reply to ALTS' opposition, filed August 24, 1992, GTE defends its rates as being a reasonable response to the competitive environment, and as fully consistent with the Commission's incentive regulation. GTE Reply at 2. See also GTE Direct Case at 14. According to GTE, it faces significant competition in the major metropolitan areas of Tampa, Los Angeles, Dallas and Seattle, and therefore appropriately selected these areas for rate reductions. Id. at 3.

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[4]These below-band rates became effective on December 15, 1992.

6. GTE also defends the method it used to identify variable costs -- the "snapshot" approach -- which GTE defines as an analysis of cost structure and level (i.e., amount of copper/fiber) on a "present day/present snapshot in time" basis -- as a reasonable, conservative approach for capturing average variable costs. Id. at 4-5. GTE maintains that it is an accepted economic standard to view incremental cost on a forward looking basis. Id. at 5. Likewise, GTE disagrees with ALTS' position that the Commission should average investment data over the most recent five-year period. GTE argues that there is no legal or academic precedent for ALTS' view, and that a five year historical perspective of costs suggests embedded cost studies and abandoned methodologies such as fully distributed cost. GTE contends that ALTS' position thus departs from the policy and direction of incentive regulation. Id.

7. ALTS next contends that the "extraordinary" cost differentials asserted by GTE among its various service areas "strongly indicate" that GTE's direct case underreports the relevant costs in the four service areas under investigation.[5] ALTS also contends that GTE underreported the costs associated with transport termination by excluding whole categories of relevant costs associated with monitoring and testing switched circuits, as well as spare equipment.[6] Additionally, ALTS contends, GTE excluded the costs of equipment racks, power supplies and fuse panels. ALTS Opposition at 9. ALTS states that the costs of billing and collection, recordkeeping, marketing and order processing were also excluded by GTE in direct violation of the Commission's price cap rules. Id. at 10-11.

8. GTE replies that its AVC study provided sufficient cost detail to justify the reasonableness of the costs involved, and that aggregation at the lowest levels is not necessary to describe adequately the variable costs involved. GTE Reply at 6. Further, GTE states, many of the items ALTS claims were excluded from GTE's study were included, but not necessarily shown at the lowest detail. Id. For example, GTE asserts, GTE included alarm equipment, equipment racks, power supplies and fuse panels in the "CO Repeater Equipment" category, and accounted for spare equipment in part through the 90 percent circuit equipment and 75 percent outside plant utilization factors. Id. at 7-8.

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[5] ALTS states that GTE's proposed premium transport termination charge for California would be set at 84 percent below GTE's Montana rates, 76 percent below its Michigan rates, 72 percent below its Illinois rates, and 55 percent below its Pennsylvania rates. Id. at 7.

[6] ALTS states that the combined cost of test and spare equipment is significant and attaches, as an example, a page from Illinois Bell's intrastate Optical Interconnection Service tariff, which shows that the total charges for its test and spare equipment amount to almost one-third of the entire variable cost GTE reports for a fiber-based special access line termination. Id. at i, 8-9.

9. Further, GTE argues, it also properly included all relevant costs (e.g., capital costs) and has treated expenses such as marketing, order processing, billing and collection, record keeping and other administrative expenses correctly in determining average variable costs. Id. at 9-10. GTE indicates however, that it need not include billing and collection expenses because they are de minimis, and is not required to allocate these expenses to the specific rate elements GTE is proposing to change. Id. at 10.

10. ALTS also argues that GTE allocated the costs associated with its tandem offices entirely to switched transport termination when such costs should have been allocated to switched transport facility, since the function of tandem offices increases transport efficiency. ALTS Opposition at 10. Further, ALTS assails GTE's methodology for determining output as vague, in that the application of network usage factors is not clarified. ALTS complains that the output is never quantified, and the methodology overstates GTE's output. Id. at 11-12.

11. GTE defends its decision to assign tandem costs to transport termination, rather than to the transport facility. GTE maintains that Part 69 of the Commission's Rules does not require tandem costs to be included in the facility element of the transport category, and states that LECs have the latitude to place these costs in either category, or to spread costs across both services in whatever manner reasonable. Since access tandem expenses are not distance sensitive, GTE asserts, it has placed these costs in transport termination. GTE Reply at 9. In challenging its method of determining output, GTE states, ALTS incorrectly assumed a 100 percent fill factor, when GTE used a 90 percent circuit equipment fill factor and 75 percent outside plant fill factor in the cost studies. GTE provides Exhibit 3 to illustrate its use of these fill factors; GTE asserts that the exhibit shows that it did not overstate output or understate cost. Id. at 12.

12. Finally, ALTS maintains, GTE's proposed rates are otherwise unreasonable because the 70-80 percent rate cuts proposed by GTE raise barriers to entry by inducing extraordinary volatility into the market, and creating regulatory uncertainty. ALTS Opposition at 15-16. GTE argues that its rates are otherwise just and reasonable because price reductions alone do not prove predatory prices and because the Commission's price cap rules and other regulatory constraints assure that the GTEs cannot abuse their position in the market.[7] GTE Reply at 12.

II. DISCUSSION

[7] On September 30, 1992, ALTS filed a pleading captioned "Ex Parte Filing" responding to GTE's reply. GTE filed an opposition and motion to strike ALTS' pleading as unauthorized and untimely on October 5, 1992; ALTS filed an opposition to the motion to strike dated October 15, 1992. We will accept ALTS' filing as a permissible ex parte presentation. See 47 C.F.R. § 1.1206. Nothing in this filing leads us to reach a different result.

13. In both the AT&T Price Cap Order[8] and the LEC Price Cap Order the Commission expressed the clear sentiment that rate reductions are generally beneficial to consumers, and are more often than not undertaken for competitive reasons.[9] Moreover, the Commission has maintained the view that proven cases of predatory pricing are rare, that below-band reductions introduced under our price cap system will more likely be pro-competitive than predatory, and that the LEC service basket structure further lessens the already unlikely occurrence of predation. In both the AT&T Price Cap Order and the LEC Price Cap Order the Commission found that average variable cost is central to determining whether prices are predatory for tariff review purposes.[10]

14. This investigation was prompted by a lack of clarity in GTE's cost support that prevented the Bureau from determining whether GTE's rates were so low as not to be just, reasonable and nondiscriminatory. Our decision in this investigation therefore needs to focus on whether those rates are predatory. In making this determination, we believe we should place great weight on whether GTE passes the average variable cost standard established in the price cap rules for tariff review of below band filings. That standard was designed as a check against predation, and is drawn from federal circuit court decisions in antitrust cases.[11]

15. In the price cap orders, the Commission specified certain types of costs which must be included in the calculation of the cost floor. The Commission stated that at a minimum, variable costs should include all access charges and billing and collection costs attributable to the service, as well as other non-fixed costs which would not be incurred if the service were not offered.[12] AVC showings submitted in the past[13] have had the following characteristics: (1) for the service in question, the unit costs of plant

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[8]Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice, 4 FCC Rcd 2873 (1989) and Erratum, 4 FCC Rcd 3379 (1989).

[9]See AT&T Price Cap Order, 4 FCC Rcd at 3114 (para 499); LEC Price Cap Order, 5 FCC Rcd at 6824 (para. 309).

[10]See AT&T Price Cap Order, 4 FCC Rcd at 3114-15 (paras. 499-500); LEC Price Cap Order, 5 FCC Rcd at 6824 (paras. 309-311).

[11]AT&T Price Cap Order at 3114-3115.

[12]See e.g., AT&T Price Cap Order, 4 FCC Rcd at 3115 (1989).

[13]See e.g., AT&T Communications Tariff F.C.C. No. 1, Transmittal No. 2777, effective January 1, 1991; AT&T Communications Tariff F.C.C. No 1, Transmittal No. 2717, effective December 30, 1990; and AT&T Communications Tariff F.C.C. No 1, Transmittal No. 2661, effective December 8, 1991.

investment,[14] network maintenance and operations, and customer operations, as well as other costs specified in the price cap orders, were included in the calculation of the cost floor; and (2) such costs were "forward-looking," i.e., costs that a new service provider seeking to offer ongoing service for a reasonable duration would face in the market today. Forward-looking costs are based on current and anticipated prices, not embedded costs, and are based on a service configuration embodying state of the art technology.[15]

16. GTE has developed its costs using a method similar to that outlined above.[16] One major difference is that GTE used a "snapshot" approach to capture the costs of its current network, thereby including more embedded (copper) facilities than would be included if the transport facility were built today. Since the cost of copper facilities exceeds that of fiber optic facilities which would predominate in the future, calculations more heavily weighted toward copper result in a higher AVC cost floor than under the method outlined above. Since GTE can show that its prices exceed the higher AVC cost floor, GTE's variation in method does not invalidate its AVC showing.[17] Another difference is that contrary to the Commission's direction in the AT&T Price Cap Order, GTE did not include billing and collection costs in the rate elements it proposes modifying. GTE has recalculated its AVC including billing and collection costs and has shown that in each study area except for Florida its proposed rates exceed AVC.[18] GTE has refiled its Florida rates to raise them above the recalculated AVC.[19]

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[14]Such costs would include "capital costs," i.e., depreciation expense, net return, and relevant taxes. See Alfred E. Kahn, The Economics of Regulation: Principles and Institutions, Vol. 1 at 32-36 (1970).

[15]"For it is current and anticipated cost, rather than historical cost, that is relevant to business decisions to enter markets and price products. . . . The historical costs associated with the plant already in place are essentially irrelevant to this decision since those costs are 'sunk' and unavoidable and are unaffected by a new production decision." MCI Communications Corporation v. American Telephone and Telegraph Company, 708 F.2d 1081, 1116-17 (7th Cir. 1983). For this reason, we reject ALTS' suggestion that a LEC average its investment over the most recent five year period.

[16]GTE provided its billing and collection costs for the affected switched access rates in an Ex Parte letter filed October 21, 1992.

[17] We note that GTE made a number of assumptions (such as average distance of the transport facility and the rounding up of the percent of fiber) which have the effect of lowering the reported average variable cost. In general, however, it appears that the effect of these assumptions is more than offset by the overall conservative nature of GTE's study methodology (e.g., the inclusion of copper facilities in determining the cost of its network).

[18]See note 15, infra.

[19]GTE Tariff F.C.C. No. 1, Transmittal No. 750, filed October 30, 1992. These rates became effective December 15, 1992.

17. GTE has demonstrated that its costs meet or exceed its average variable cost, and has thus made the showing required for below-band rates. GTE has also adequately addressed ALTS' allegations that GTE underreported costs and overestimated service output.[20] In addition, there is nothing else in the record to support a conclusion that GTE's rates are otherwise unreasonable or unreasonably discriminatory. Accordingly, we find that GTE's rates are lawful.

III. ORDERING CLAUSES

18. Accordingly, IT IS ORDERED that the investigation of GTE's below band transport rates initiated by the Common Carrier Bureau in the 1992 Annual Access Order IS TERMINATED.

19. IT IS FURTHER ORDERED that GTE's motion to strike ALTS' "Ex Parte Filing" IS DENIED.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton

William F. Caton
Acting Secretary

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[20]See paras. 8, 9, and 11 supra.